

**LEGISLATIVE SERVICES AGENCY  
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**FISCAL IMPACT STATEMENT**

**LS 6704**

**BILL NUMBER:** HB 1461

**NOTE PREPARED:** Feb 20, 2007

**BILL AMENDED:**

**SUBJECT:** Tax Exemption for Patent-Derived Income.

**FIRST AUTHOR:** Rep. Bosma

**FIRST SPONSOR:**

**BILL STATUS:** CR Adopted - 1<sup>st</sup> House

**FUNDS AFFECTED:** X GENERAL  
X DEDICATED  
FEDERAL

**IMPACT:** State & Local

**Summary of Legislation:** The bill exempts from taxation certain income derived from patents and earned by a taxpayer that is domiciled in Indiana and considered a small entity by the United States Patent and Trademark Office. It provides that the aggregate amount of exemptions claimed by a taxpayer in a taxable year may not exceed \$5,000,000. It also provides that a taxpayer may not claim an exemption for income derived from a particular patent for more than ten years.

**Effective Date:** January 1, 2008.

**Explanation of State Expenditures:** The Department of State Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new exemption for patent-derived income. The DOR's current level of resources should be sufficient to implement the new exemption.

**Explanation of State Revenues: Summary:** The bill would reduce state Adjusted Gross Income (AGI) Tax or Financial Institutions Tax liabilities of taxpayers that derive income from patents issued after December 31, 2007. The potential revenue loss to the state from this exemption is indeterminable and could begin in FY 2009. The maximum exemption a taxpayer may claim in a taxable year is \$5 M. The maximum exemption amount translates into a \$170,000 reduction in tax liability for an individual taxpayer, and a \$425,000 reduction in tax liability for a corporate taxpayer or financial institution. Thus, if 10 taxpayers qualify for the maximum exemption amount each year, the annual revenue loss could range from \$1.7 M (if all the taxpayers are individuals) to \$4.25 M (if all the taxpayers are corporations).

***Background Information:*** The bill establishes an exemption from the AGI Tax and the Financial Institutions Tax for certain income derived in the taxable year from patents issued to "qualified taxpayers" after

December 31, 2007. The aggregate amount of patent-related income a taxpayer may exempt in a taxable year is \$5 M. A taxpayer may claim the exemption for not more than ten years. An average of about 1,500 patents have been issued annually to persons or entities in Indiana since 1995. However, annual patent totals for Indiana have declined in recent years from a high of 1,745 in 2002 to 1,246 in 2005. Data is unavailable describing the typical income generated by patents and the number of persons or entities annually receiving patents in Indiana that meet the criteria for the exemption. The patent-derived income that would be exempt under the bill is: (1) licensing fees or other income received for the use of a patent; (2) royalties received for the infringement of a patent; and (3) receipts from the sale of a patent. The bill defines a "qualified taxpayer" as a taxpayer that is:

(1) Considered a small entity by the U.S. Patent and Trademark Office, defined as an independent inventor, small business concern, or nonprofit organization eligible for reduced patent fees.

(2) Domiciled in Indiana.

Since the exemption is effective beginning in tax year 2008, the fiscal impact would begin in FY 2009. Revenue from the corporate AGI Tax and the Financial Institutions Tax is deposited in the state General Fund. The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** Because the exemption for individuals receiving patent-related income would decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties with a local option income tax.

**Information Sources:** *Patents by Country, State and Year - All Patent Types (December, 2005)*, U.S. Patent and Trademark Office, Electronic Information Products Division, Patent Technology Monitoring Branch, [http://www.uspto.gov/web/offices/ac/ido/oeip/taf/cst\\_all.htm](http://www.uspto.gov/web/offices/ac/ido/oeip/taf/cst_all.htm).

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